

No. [REDACTED] 28

IN THE

Supreme Court of the United States

OCTOBER TERM, 1943

CLARIDGE APARTMENTS COMPANY, a corporation,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE
UNITED STATES CIRCUIT COURT OF APPEALS
FOR THE SEVENTH CIRCUIT AND BRIEF
IN SUPPORT THEREOF.

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PETITION FOR WRIT OF CERTIORARI.

To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Your petitioner, Claridge Apartment Company, an Illinois Corporation, by its attorneys, John E. Hughes, Walter Hamilton, Jesse Andrews and Cornelius E. Lombardi, prays that a Writ of Certiorari issue to review the decision of the United States Circuit Court of Appeals for the Seventh Circuit, entered December 1, 1943, in case No. 8297 below, reversing the judgment of the Tax Court of the United States in the above entitled case (No. 8297 below). (R. 238)

Opinions Below.

The opinion of the Tax Court of the United States is reported in 1 T. C. 163 and appears in this record at page 183. The opinion of the Circuit Court of Appeals is reported in 138 F. (2d) 963 and appears in this record at page 228.

Jurisdiction of the Court.

The jurisdiction of this court is invoked under Section 240 (a) of the Judicial Code as amended (28 U. S. C. A. §347, (a)).

Questions Presented.

(1) Is indebtedness "canceled or reduced", within the meaning of the Chandler Act, when the creditors take over the debtor's property for such indebtedness? To put it another way—when a mortgagee forecloses and takes the mortgagor's home, does he thereby "cancel or reduce" the mortgagor's debt? If the Tax Court was right in its conclusion on this point and the court below wrong in reversing it, the other questions in this case are moot.

(2) Conceding that Section 270 of the Chandler Act, enacted September 22, 1938, applies to plans confirmed before its enactment, is it retroactive so as to apply to the computation of taxes for years prior to its enactment as the court below held, or does it only apply to such plans for purpose of tax computation starting with the year of its enactment, as the Tax Court held?

(3) If, as constructed by the Court below, it applies to impose additional 1935 tax, does it violate the due process clause of the Fifth Amendment?

(4) Conceding section 270 applies to plans confirmed before its enactment since, as here, nearly two years and sometimes more, often elapse between confirmation of a plan and final decree, does section 270 only apply where the proceeding was not pending when it was enacted?

(5) Was there a rational basis for the decision of the Tax Court, which the court below reversed?

Statutes Involved.

The statutes involved are set forth in the appendix hereof at pages 21 to 23.

Statement of Matter Involved.

This case involves income tax deficiencies for the calendar years 1935, 1936, 1937 and 1938 and excess profits tax deficiencies for 1935 and 1938.

Section 270 of the Chandler Act was enacted September 22, 1938. The Tax Court held that it applied to all plans before its enactment but it was not retroactive so as to govern computation of deficiencies for the years 1935, 1936 and 1937 but only applicable to the computation of the deficiency starting with 1938—the year of its enactment. The Circuit Court of Appeals for the Sixth Circuit in *Commissioner v. The Commodore, Inc.*, 135 F. (2d) 89, affirmed a decision of the Board of Tax Appeals so holding (46 B. T. A. 718). The court below announced its disagreement with this decision of the Sixth Circuit and reversed the Tax Court.

The second question is whether, conceding sections 270 and 268 apply to plans confirmed before their enactment, does the Statute (Appendix 22) limit their application to cases which were pending at the date of their enactment and cases arising in the future?

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The third presented question here is whether (for 1938, to which the Tax Court held Section 270 applied) petitioner's indebtedness was "canceled or reduced" within the meaning of section 270. The Tax Court held it was not. The court below reversed the Tax Court and held it was. If the Tax Court was right on this point, it disposes of this case and under the other questions moot.

The salient facts on this point are as follows:

The Claridge Building Corporation owned an apartment building in Chicago. It had cost it \$424,609.19 to build. On June 16, 1934 it had outstanding \$277,000 six and one-half per cent first mortgage bonds on which principal and interest were in default. On that date it filed a voluntary petition in the United States District Court, under Section 77B of the National Bankruptcy Act.

A plan of reorganization was entered into and confirmed by the Court May 14, 1935 (final decree March 1, 1937) whereby petitioner corporation was formed with 3080 shares of no par value stock and the property of the debtor transferred to it. Its shares were issued on September 2, 1935, one for each \$100. face value bond, 2770 being issued to the bondholders, 308 shares to the debtor's stockholders, and 2 shares being unissued.

Respondent contended the debt of the old corporation was "canceled or reduced" by the difference between the fair market value of the stock issued to the bondholders and the face value of their bonds. (We submit, if any debt was canceled or reduced by this proceeding, it was all canceled.) The Tax Court reversed and held the debt was not thereby "canceled or reduced". The Court of Appeals reversed the Tax Court and held it was "canceled or re-

duced" by the difference between the \$277,000 face value of the bonds and the market value of the stock issued to the bondholders which market value was \$124,650. The fair market value of the building on May 14, 1935, was \$141,000.

Reasons for Granting the Writ.

First—The decision below in holding section 270 retroactively applicable to the computation of taxes for years before its enactment is in conceded and square conflict with the decision of the Circuit Court of Appeals for the Sixth Circuit in *Commissioner v. The Commodore, Inc.*, 135 F. (2d) 89.

Second—The question whether debt is canceled or reduced in circumstances such as this exists in hundreds of 77B reorganizations. In cases arising in other circuits The Tax Court will probably adhere to the view it expressed in this case. The government will appeal if it does. Taxpayers will appeal if it does not. Litigation and settlement of hundreds of cases will be prolonged unless the writ is granted and this question settled now. A question of great importance in tax law, which has not been but should be settled by this court, is involved.

In *Alcazar Hotel, Inc.*, 1 T. C. 873 (pending on appeal, C. C. A. 6th), the Tax Court said (p. 879):

"This contention, too, may be disposed of by reference to our decision in *Claridge Apartments Co., supra*. Following *Capitol Securities Co.*, 47 B. T. A. 694, we held the substitution of common stock for bonds did not effect a cancellation or reduction of indebtedness, but rather amounted to a continuation of the obligation in another form."

The Circuit Court of Appeals for the First Circuit has just affirmed the Board's decision in the *Capento Securities Co.* case. 1944 C. C. H. Tax Service, par. 9170.

Third—When the court below upset The Tax Court's decision it did not have the benefit of this court's decision in the *Dobson* case, holding a Tax Court decision resting upon a rational basis cannot be upset.

Fourth—The decision of the court below on questions (1) and (2) is patently wrong (see annexed brief) and that of The Tax Court is obviously right—a circumstance which will multiply and prolong litigation until the question is settled by this court.

Wherefore, it is respectfully submitted that this court should grant the writ of certiorari to review the decision of the Circuit Court of Appeals for the Seventh Circuit in case Number 8297 below.

JOHN E. HUGHES,

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COMMISSIONER OF INTERNAL REVENUE,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

In *Dobson v. Commissioner*, 320 U. S. _____, this court said:

"The judicial function is exhausted when there is found to be a rational basis for the conclusions approved by the administrative body" (citing many cases).

The Court of Appeals for the District of Columbia has just stated this is the only question before a court of appeals in ordinary appeals from the Tax Court. *Commissioner v. Celanese Corporation*, C. C. H. Tax Service, 1943, paragraph 9147.

Tested by this rule the court below had no right to reverse the decision of the Tax Court in the case at bar.

I.

The debt was not "canceled or reduced" within the meaning of Section 270.

The Tax Court properly so held and the court below improperly reversed. If the Tax Court was right the other questions in the foregoing petition are out of the case.

The Tax Court held the facts in the case at bar gave rise to a non taxable reorganization and respondent did not appeal this point to the court below.

In a reorganization the basis of the old corporation carries over to the new (*Palm Springs Holding Company v. Commissioner*, 315 U. S. 185) and, by the express provisions of section 113 (b)(3) of the Internal Revenue Code and pre-existing provisions of the revenue acts, bondholders and stockholders of the old corporation, who received stock in the new one, are denied any loss. Also section 112 (b) (4) prevented either corporation realizing any income. These provisions long antedated the Chandler Act.

If any debt was "canceled or reduced" in this case all of it was canceled or reduced, which reveals the absurdity of the construction of the court below because there would then be a zero basis to many corporations organized under 77B. The 1940 Amendment prevented the reduction going beyond the fair market value but the meaning of the 1938 Act was fixed at the date it became law and surely Congress could not have intended this in a bankruptcy act designed for the relief of debtors.

Meaning of the words "canceled or reduced."

A cancellation occurs when an indebtedness is not accorded recognition in a plan of reorganization and a reduction occurs only when the indebtedness is accorded recognition in a reduced amount. Where recognized to the extent of its full amount the debt has not been "reduced or canceled" regardless of the nature of the provisions with respect thereto.

In virtually every reorganization the value of the property is less than the face amount of debt yet the full amount of the senior debt is recognized by issue of stock and the junior debt canceled. The value of the property and the actual value of the senior debt are the same in cases where the debt accorded recognition takes the entire property. Also, in most large reorganizations secondary bond or note issues were canceled and not recognized.

In cases where the value of the property is not in excess of the first lien debt no provision for secondary debt is made and it is thereby canceled. If the value of the property exceeds the first lien debt, but doesn't equal the junior debt, the secondary debt is often recognized only in part.

If Congress had intended that debt fully recognized in a reorganization and exchanged for stock be considered "canceled or reduced" it could have precisely said so, leaving no room for doubt and uncertainty.

Section 268 arose from the suggestion of Mr. Banks, a member of the National Bankruptcy Committee and section 270 from the suggestion of Mr. Kent of the Treasury. See Judiciary Committee Hearings on Revision of the Bankruptcy Act, 75 Congress, 1st session, pages 266 to 268 and 352 to 354. Kent's example at page 353 supports the construction for which we contend. He said if a corporation bought property for \$1,000,000, later became financially involved and the seller reduced the price to \$750,000, and thereafter conditions improved and it sold the property for \$1,000,000, the \$250,000 profit would escape tax if a \$1,000,000 base was used. The committee report shows Congress intended to provide for cases such as that and not cases like this at bar.

The first rule of statutory construction is "unless Congress has definitely indicated its intention that the words should be considered otherwise, we must apply them according to their usual acceptation." *Arery v. Commissioner*, 292 U. S. 210, 214. As said in 53 Harvard Law Review at page 1009: "In popular parlance no one would ordinarily use the words 'canceled or reduced' in speaking, for example, of the conversion of debt into stock in a purely capital transaction." On the other hand, if we assume the meaning of the words is doubtful then the rule of statutory construction is "if doubt exists as to the construction of a taxing statute the doubt should be resolved in favor of the taxpayer." *Hassett v. Welch*, 303 U. S. 303, 314, and cases there cited.

It is submitted the words are not doubtful but, if they are doubtful, then resort should be had to the intention of Congress as disclosed in the report of the committee reporting the bill. This intention was to cover cases such as embraced in note 1 hereof and not cases like the one at bar.

The Senate Judiciary Committee report referred to "debt forgiveness" stating:

"This provision is intended to prevent a double deduction. Where debt forgiveness resulting from a debt readjustment is exempt from tax upon income or profit, the cost of the property dealt with by the settlement is to be decreased for future tax purposes, by an amount equal to the amount of the indebtedness canceled or reduced in the proceeding." (S. Rep. No. 1916: 75th Congress, 3rd Session, page 39.)

There was no "debt forgiveness" here. If the debt of the old company had been forgiven or canceled it could have continued in business free of debt. The creditors, instead of forgiving or canceling their debt, exacted their full pound of flesh and, in effect, foreclosed the mortgage.

There was no double deduction because there was no income for section 268 to exempt from tax.

Not only did the court below fail to perceive the effect of the reorganization provisions on the situation (page 17 hereof) but its opinion discloses a misconception of the base and reason for the depreciation allowance such as should lead this court to extend its decision in the *Dobson* case limiting the scope of review.

• The court below says:

"It would be both illogical and unfair to retain a fictitious depreciation basis for tax purposes when the actual valuation in the reorganization of the debtor was much less. Congress was dealing with realities. It sought not only to avoid injustice to the Government, but also prevented injustice being done to the taxpayer. It should be noted that Section 270 contained a provision which prevented the depreciation basis going below the fair value of the building.

"If taxpayer's construction of this section be adopted, then a reorganized debtor could claim a depreciation based upon a value twice or three times as much as the real value of the building."

What the Court overlooks here are two things:

1. That a depreciation basis represents the capital that a taxpayer is entitled to have returned to it free of tax. The Court seems to think that if in some way this basis has come to exceed the actual value of the property, it is "a fictitious depreciation basis" and the retention of it is "both illogical and unfair". This is not so. It matters not how much the depreciation basis exceeds the actual value of the property nor how much the property exceeds the depreciation base. It would be illogical, unfair and an unconstitutional capital levy to reduce it, until and unless the taxpayer has been given an equivalent in return for

such reduction. Sec. 270 can constitutionally apply in the cases in which it was intended to apply, because in those cases the taxpayers will have been accorded relief by Sec. 268 from tax liability resulting, pursuant to the *Kirby Lumber Company* case, from a modification or cancellation of their indebtedness. The depreciation base and base for computing profit on sale are the same—cost.

2. The second thing the Court overlooks is that it is entirely consistent with law and expressly provided for a reorganized debtor to be able to "claim a depreciation based upon a value twice or three times as much as the real value of the building" or on one-half of its value if the building has appreciated. The basis is cost. It is assumed here that the reorganized debtor is legally entitled to the same depreciation basis as its predecessor, absent any question of debt reduction or cancellation. This relation of the depreciation basis to the actual value of the property may be utterly immaterial on the question of the debtor's right to use it. What the debtor is entitled to, in such circumstances, is the return of the capital represented by the amount of the depreciation basis, altogether irrespective of whether this is less than, equal to, or in excess of the actual value of the property. To hold otherwise is to turn capital invested into income and an income tax into a capital levy. See page 14 hereof.

The Court seems to think there is something inherently wrong in a company's retaining a depreciation basis higher than the actual value of the property, and this, too, no matter how the excess resulted, no matter how truly the depreciation basis may represent the undepreciated cost of the property to the company. This, the court calls "a fictitious depreciation basis". Such a view displays, we submit, a wholly erroneous concept of depreciation. Until

the taxpayer has had his capital returned to him, its cost, less depreciation, is the true basis, however much this may, at the time, exceed the actual value and the revenue act is drafted on this theory.

One of the first principles of income tax law, furthermore, is that changes in value of a taxpayer's property are not recognized until they are reflected in some definite taxable transaction, such as a sale of the property. If the principle which the Court adopts should be applied generally, the result would be revolutionary. A taxpayer could successfully claim a loss whenever one of his assets had diminished in value. A profit might be claimed on unrealized appreciation.

The court below also says:

... Sections 268 and 270 are complementary. Section 268 relieves the debtor corporation of a tax on any of its income represented by the cancellation of an indebtedness in a reorganization proceeding under Chap. X. *We must read Section 270 in the light of this Sec. 268 tax exemption.* (Italics ours.)

Debtor reorganization under the Bankruptcy Laws nearly always results in a reduction of the outstanding indebtedness. In fact, reorganizations are for the avowed purpose of avoiding the evil effects of overindebtedness. This accomplished, when the reorganizations are in good faith, by reduction or the elimination of all or a part of such debt burden.

"Such a reduction of the debt of the reorganized debtor, however, might result in a so-called profit to the corporation. This occurs by reason of the lessening, or extinction, of its debt. By Section 268, Congress provided for this contingency and relieved the debtor from an income tax on such a possible charge of profits. On the other hand, were it not for Section 270, the debtor would profit unfairly. It would continue a depreciation base for tax purposes that is out

of line with its actual value. It would be getting a benefit, which it should receive, under Section 268, but at the same time it would evade its taxes in so far as they reflected a false and exaggerated depreciation base.

But the Court did not give effect to this dependence of Sec. 270 on Sec. 268 in reversing The Tax Court on the point above mentioned. If it had, its decision would have been the other way. Section 268 did not exempt any income here.

A bondholder who invests \$1000. in a bond makes no profit when he exchanges it for stock in a 77B case. He cannot deduct any loss if it is a nontaxable reorganization as this was. (Sec. 112 (b) (3), I. R. C.) A corporation which transfers its property to another corporation for its stock makes no profit because the property is the subscription price of the stock and if the transfer is in a reorganization, as defined in the revenue act, which the Tax Court held this was, there is no recognizable loss of profit.

The opinion of the court below assumes the major premises upon which it rests. It begs the questions. It rests on the assumption that the old corporation made a profit which would have been taxable to it but for section 268. This is not so. When this assumption falls, the opinion below falls with it.

Furthermore, the construction placed upon the Act by the court below creates a great discrimination between 77B and other reorganizations.

The Court speaks of the Claridge Apartments Company "getting a benefit, which it should receive, under Sec. 268, but at the same time (evading) its taxes insofar as they reflected a false and exaggerated depreciation base". In what way, or in what amount, it may be asked, could the

income tax liability of Claridge Apartments Company have been increased in 1935 (the year of the reorganization) as a result of the substitution of stock for bonds? *No debt had been written down or canceled in the sense that such change would create income tax liability under the doctrine of the Kirby Lumber Company case or under the taxing statutes.*

The Court is on no sounder ground when it undertakes to find the reason for the enactment of Sec. 270 and to apply it as a support to the construction of the Section given. It says:

"The financial crash of '29 caused values of real estate and buildings thereon to tumble. The Chandler Act deal with the reorganization of companies which held such properties. It dealt with debtors that had outstanding mortgages and other indebtedness in excess of the value of their real properties. When the reorganization of these debtors was completed, in many instances the indebtednesses were greatly reduced or cancelled. In the instant case the debt was entirely eliminated. In place thereof, stock of much less market value than the face value of the debt, was issued."

Whatever the reasons for the enactment of the Chandler Act the reasons for the insertion in it of 268 and 270 appear in the Committee Hearings and the Committee report to which the court below does not refer (See note 1 hereof).

The court below quotes an opinion of this court that capital stock is not a debt (R. 232). This is another false issue. No one asserts it is a debt. The Tax Court said one liability was substituted for another in this transaction. The word liability is much broader than the word debt and capital stock is a liability. See *Commissioner v. Capento Securities Co.* (C. C. A. 1st), published in C. C. II, 1944

Tax Service, Paragraph 9170. A corporation owes many duties to its stockholders.

If the 77B proceeding had not been a non-taxable reorganization (the tax Court held it was and respondent did not appeal) the bondholders of the debtor, who received stock, could have charged off their loss and it would be wrong for them to again get the benefit of the loss thus charged off, in depreciation deductions. This would be a double benefit. Also, the debtor corporation would have sustained a recognizable loss. However, the Tax Court found a non-taxable reorganization took place and, as pointed out on page 14 hereof, neither the bondholders nor stockholders nor the debtor corporation could deduct any loss.

The court below says:

"Finally, if we give the same effective date of application to both Sections 268 and 270, we are dealing with realities, with facts as they are. We are relieving an involved debtor from an income tax on a profit which it did not make when its debts were reduced; and we are asking it to figure its depreciation on a basis which accords with the facts, not with figures that are fictional and have no connection with values of today. Why should we attribute to words of a statute a meaning which would continue the make-believe, water values that were wrung out of them in the reorganization proceedings."

If, as the court below says, the debtor did not make a profit there was no income tax to relieve it of. Furthermore, there are no "water values" involved. Every dollar paid for the bonds was used to erect the building and so far as the investors were concerned every dollar of their money was still in that building when they reorganized it.

Also, the cost to the corporation of the building (cost basis for depreciation) had not diminished.

Also, section 268 did not relieve the debtor from any tax because in a non taxable reorganization, such as we have here, section 112 (b) (4) of the I. R. C., which existed years before the Chandler Act and now exists, expressly provides:

“(4)—Same.—Gain of Corporation.—No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization solely for stock or securities in another corporation a party to the reorganization.”

Since the court below holds section 270 was intended to compensate for tax lost because of section 268, it should have affirmed the Tax Court because section 268 did not relieve the debtor from any tax.

Consider the absurd consequences of the decision below. You invest \$500,000. in all the bonds of a corporation and it builds an apartment house with this \$500,000. Values shrink in a depression and you exchange your bonds for stock worth \$100,000. at market but the transaction, being a non taxable reorganization, neither you nor the old or new corporation realizes any profit or loss. A boom time comes and the new corporation sells the building for cost less depreciation, say for \$350,000. Under the holding of the court below it has a taxable profit of \$250,000. You can never recover your investment. The effect is to tax the capital invested by you as income. It is submitted Congress never intended such absurd results. The situation it sought to reach is the one contained in the example given by Kent and mentioned in note 1, at page 9 hereof. Furthermore, the construction of the court below creates

an indefensible discrimination between 77B and other reorganizations.

II.

Section 270 is not retroactive so as to affect tax liability prior to the year of its enactment.

The words of the Statute are (Appendix 23):

"(3) sections 268 and 270 of this Act shall apply to any plan confirmed under section 77B before the effective date of this amendatory Act and to any plan which may be confirmed under section 77B on and after such effective date."

The court below quotes these words in its opinion and states:

"Given their ordinary meaning the words 'before the effective date of this amendatory Act' mean that if the Act applies to reorganizations which were completed before June 22, 1938."

In so holding the court below decided a false issue not present in this case and not in dispute.

Of course, the Act applies to 77B plans confirmed before its enactment. Everyone admits that and it was not even an issue in this case.

The decision of the Tax Court in this case was that it applied to this plan although confirmed before the Act was passed. That is the most the Act says. It does not say it applies retroactively in computing tax liability or that it applies in computing the tax liability for years prior to the year of its enactment. It merely means that from the year of its enactment it applies in computing tax liability of any plan confirmed before the effective date of the

amendatory Act". (Whether the Statute limits this to pending cases is discussed on page 20 hereof.)

A reading of the opinion of the court below discloses it does not touch this issue. It decides a false issue—a point conceded by all and assumes it determines the case.

In a very carefully considered opinion in *The Commodore* 46 B. T. A. 717 at page 723, the Board of Tax Appeals quoted the report of the Senate Judiciary Committee that section 2270 applies "for future tax purposes" and so held, as it also held in the case at bar. The Board was affirmed in *The Commodore* case by the Sixth Circuit in 135 F. (2d) 89 and this case conflicts therewith.

The provisions of the Chandler Act do not apply to proceedings pending when it was enacted with three exceptions applicable only to pending proceedings.

The Tax Court correctly held the Chandler Act applied to plans confirmed before its enactment but applied to them prospectively only but failed to notice that for it to apply to such plans the proceeding must have been pending when it was enacted.

The Tax Court overlooked that the Chandler Act did not apply to pending proceedings except with three specific exceptions—all of which referred only to pending proceedings. (For statute see Appendix, page 22.)

In the case at bar the plan was confirmed May 14, 1935 (R. 187) and final decree was rendered March 1, 1937 (R. 187). The proceeding was not pending when the Chandler Act became law on September 22, 1938.

The point we raise here is not a question of tax law but purely one of statutory construction.

Section 276 c (Appendix 22) declares:

c. the provisions of section 77A and 77B of chapter VIII, as amended, of the Act entitled "An Act to establish a uniform system of bankruptcy throughout the United States", approved July 1, 1898, shall continue in full force and effect with respect to proceedings pending under those sections upon the effective date of this amendatory Act, except that . . .

The three exceptions which follow, (1), (2) and (3), are all keyed to the above quoted general rule, *which refers only to pending proceedings*. Exception (3) therefore means sections 268 and 270 apply to any plan confirmed before its enactment if the proceeding was pending when it was enacted. In other words, the statute says it does not apply at all to pending proceedings except if the proceeding is pending then sections 268 and 270 apply to it.

If the proceeding was pending a plan confirmed two years previously could be vacated and reformed so as to give the greatest possible relief to the bankrupt and thus any unfairness of retroactivity could be avoided in such case and a taxpayer could not say, "If the rule had been in force I would have played differently."

The writ should be granted and the Tax Court's decision affirmed on the points of non retroactivity and non correlation of debt.

All of which is respectfully submitted.

JOHN E. HUGHES,

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Counsel for Petitioner

APPENDIX.

Bankruptcy Act of July 1, 1898, c. 541, 30 Stat. 544, as amended by the Act of June 22, 1938, c. 575, 52 Stat. 840, Sec. 1:

Sec. 268. Except as provided in section 270 of this Act, no income or profit, taxable under any law of the United States or of any State now in force or which may hereafter be enacted, shall, in respect to the adjustment of the indebtedness of a debtor in a proceeding under this chapter, be deemed to have accrued to or have been realized by a debtor, by a trustee provided for in a plan under this chapter, or by a corporation organized or made use of for effectuating a plan under this chapter by reason of a modification, in or cancellation in whole or in part of any of the indebtedness of the debtor in a proceeding under this chapter.

(U. S. C. 1940 ed., Title 11, Sec. 668.)

Sec. 269. Where it appears that a plan has for one of its principal purposes the avoidance of taxes, objection to its confirmation may be made on that ground by the Secretary of the Treasury, or, in the case of a State, by the corresponding official or other person so authorized. Such objections shall be heard and determined by the judge, independently of other objections which may be made to the confirmation of the plan, and if the judge shall be satisfied that such purpose exists, he shall refuse to confirm the plan.

(U. S. C. 1940 ed., Title 11, Sec. 669.)

Sec. 270. [as further amended by the Act of July 1, 1940, c. 500, 54 Stat. 709]. In determining the basis of property for any purposes of any law of the United States or of a State imposing a tax upon income, the basis of the debtor's property (other than money, as is

transferred to any person required to use the debtor's basis in whole or in part shall be decreased by an amount equal to the amount by which the indebtedness of the debtor, not including accrued interest unpaid and not resulting in a tax benefit on any income tax return, has been canceled or reduced in a proceeding under this chapter, but the basis of any particular property shall not be decreased to an amount less than the fair market value of such property as of the date of entry of the order confirming the plan. Any determination of value in a proceeding under this chapter shall not be deemed a determination of fair market value for the purposes of this section. The Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe such regulations as he may deem necessary in order to reflect such decrease in basis for Federal income tax purposes and otherwise carry into effect the purposes of this section.

(U. S. C. 1940 ed., Title 11, Sec. 670.)

Sec. 276.

c. the provisions of section 77A and 77B of chapter VIII, as amended, of the Act entitled "An Act to establish a uniform system of bankruptcy throughout the United States," approved July 1, 1898, shall continue in full force and effect with respect to proceedings pending under those sections upon the effective date of this amendatory Act, except that:

(1) if the petition in such proceedings was approved within three months prior to the effective date of this amendatory Act, the provisions of this chapter shall apply in their entirety to such proceedings;

(2) if the petition in such proceedings was approved more than three months before the effective date of this amendatory Act, the provisions of this chapter shall apply to such proceedings to the extent that the judge shall deem their application practicable; and

(3) sections 268 and 270 of this Act shall apply to any plan confirmed under section 77B before the effective date of this amendatory Act and to any plan which may be confirmed under section 77B on and after such effective date, except that the exemption provided by section 268 of this Act may be disallowed if it shall be made to appear that any such plan had for one of its principal purposes the avoidance of income taxes, and except further that where such plan has not been confirmed on and after such effective date, section 269 of this Act shall apply where practicable and expedient.

(U. S. C. 1940 ed., Title ii, Sec. 676.)

Treasury Regulations 86, promulgated under the Revenue Act of 1934, as amended by T. D. 4871, 1938-2 Cum. Bull. 130, and T. D. 5003, 1940-2 Cum. Bull. 107.

Art. 113 (b)—2. Adjusted basis: Cancellation of indebtedness.—In addition to the adjustments provided in section 113 (b)(1) and article 113 (b)—1 which are required to be made with respect to the cost or other basis of property, a further adjustment shall be made in any case in which there shall have been a cancellation or reduction of indebtedness in any proceeding under section 12, 74 (except in the case of a "wage earner" as defined in the Bankruptcy Act, as amended), or 77B or under Chapter X, XI, or XII of the Bankruptcy Act of 1898, as amended.

For the purposes of this article—

(A) Basis shall be determined as of the date of entry of the order confirming the plan, composition or arrangement under which such indebtedness shall have been canceled or reduced;

(B) Except where the context otherwise requires, property means all of the debtor's property other than money;

(C) No adjustment shall be made by virtue of the cancellation or reduction of any accrued interest unpaid which shall not have resulted in a tax benefit in any income tax return;

(D) The phrase "indebtedness incurred to purchase" includes (i) indebtedness for money borrowed and applied in the purchase of property and (ii) an existing indebtedness secured by a lien against the property which the debtor, as purchaser of such property, has assumed to pay; and

(E) The term "fair market value" has reference to such value as of the date of entry of the order confirming the plan, composition or arrangement under which said indebtedness shall have been canceled or reduced.

Any determination of value in a proceeding under the Bankruptcy Act, as amended, shall not constitute a determination of fair market value for the purposes of this article.

The basis of any of the debtor's property which shall have been transferred to a person required to use the debtor's basis in whole or in part shall be determined in accordance with the provisions of this article.

Article 113 (b) — 2, Treasury Regulations 94, as amended by the same Treasury Decision, is identical with the above quoted article.

